

**BEFORE THE**  
**PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA**

In Re:	)	
	)	
BellSouth Telecommunications, Incorporated d/b/a	)	Docket No. 2010-14-C
AT&T Southeast d/b/a AT&T South Carolina v.	)	
Affordable Phone Services, Incorporated d/b/a	)	
High Tech Communications	)	
	)	
BellSouth Telecommunications, Incorporated d/b/a	)	Docket No. 2010-15-C
AT&T Southeast d/b/a AT&T South Carolina v.	)	
Dialtone & More Incorporated	)	
	)	
BellSouth Telecommunications, Incorporated d/b/a	)	Docket No. 2010-16-C
AT&T Southeast d/b/a AT&T South Carolina v.	)	
Tennessee Telephone Service, LLC d/b/a Freedom	)	
Communications USA, LLC	)	
	)	
BellSouth Telecommunications, Incorporated d/b/a	)	Docket No. 2010-17-C
AT&T Southeast d/b/a AT&T South Carolina v.	)	
OneTone Telecom, Incorporated	)	
	)	
BellSouth Telecommunications, Incorporated d/b/a	)	Docket No. 2010-18-C
AT&T Southeast d/b/a AT&T South Carolina v.	)	
dPi Teleconnect, LLC	)	
	)	
BellSouth Telecommunications, Incorporated d/b/a	)	Docket No. 2010-19-C
AT&T Southeast d/b/a AT&T South Carolina v.	)	
<u>Image Access, Inc. d/b/a New Phone</u>	)	

**DIRECT TESTIMONY OF**  
**JOSEPH GILLAN**  
**ON BEHALF OF**  
**AFFORDABLE PHONE SERVICES, INCORPORATED D/B/A HIGH TECH**  
**COMMUNICATIONS**  
**DIALTONE & MORE INCORPORATED**  
**TENNESSEE TELEPHONE SERVICE, LLC D/B/A FREEDOM**  
**COMMUNICATIONS USA, LLC**  
**ONETONE TELECOM, INCORPORATED**  
**DPI TELECONNECT, LLC**  
**AND**  
**IMAGE ACCESS, INC. D/B/A NEW PHONE**

1 **I. Introduction**

2 **Q. Please state your name, address and occupation.**

3  
4 A. My name is Joseph Gillan. My business address is PO Box 7498, Daytona Beach,  
5 Florida, 32118. I am consulting economist with a practice specializing in  
6 telecommunications.

7  
8 **Q. On whose behalf are you filing rebuttal testimony?**

9  
10 A. I am filing rebuttal testimony on behalf of Affordable Phone Services,  
11 Incorporated d/b/a High Tech Communications, Dialtone & More Incorporated,  
12 Tennessee Telephone Service, LLC d/b/a Freedom Communications USA, LLC,  
13 OneTone Telecom, Incorporated, dPi Teleconnect, LLC and Image Access, Inc.  
14 d/b/a New Phone. I previously filed direct testimony in this proceeding on behalf  
15 of these same clients.

16  
17 **Q. What is the purpose of your rebuttal testimony?**

18  
19 A. The purpose of my rebuttal testimony is to address AT&T's testimony (filed by  
20 Dr. Taylor) that proposes to apply the wholesale discount to reduce the value of  
21 any cash-back promotion offered to a reseller.

1       **Q.     Can you summarize in simple terms the core issue raised by the cash-back**  
2       **promotion?**

3  
4       A.     Yes. Although the issue is particularly important to my clients – and AT&T’s  
5       objections/testimony remarkably lengthy – there is but a single, simple, dispute,  
6       easily identified by a comparison of the following equations:<sup>1</sup>

7  
8                   **Reseller Proposal**

9  
10                  Wholesale Rate = (Discount) x (Retail Rate) – (Cash-Back)

11  
12                  **AT&T Proposal**

13  
14                  Wholesale Rate = (Discount) x (Retail Rate) – (Discount) x (Cash-Back)

15  
16       The central issue is whether the discount factor<sup>2</sup> should be applied *once* (*i.e.*, to  
17       the retail rate only) as recommended in my testimony and the testimony of Dr.  
18       Klein, or applied *twice* as proposed by AT&T (*i.e.*, once to the retail rate and a  
19       second time to the cash-back promotion). In the rebuttal below, I explain why it  
20       is appropriate to only apply the discount a single time (to the standard retail rate),  
21       thereby removing the appropriate level of avoided costs as determined by the  
22       Commission’s cost study and federal rules.

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<sup>1</sup>       I once had a professor claim that if picture was worth a thousand words, an equation was worth a thousand pictures. I have not generally found this to be true in the real world (that is, life after graduate school). Nevertheless, in this particular circumstance, reducing the controversy to a comparison of two simple equations does make it easier to illustrate the dispute and make clear exactly where and how the parties differ.

<sup>2</sup>       The term “Discount” in the above equations to refer to the mathematical factor used to reduce the retail rate to a wholesale rate by removing the Commission determined percentage of avoided costs. To be precise, the term “Discount” in the above equations is calculated as (1 – Avoided Cost %). For instance, if the avoided cost adopted by a Commission is 15%, the Discount factor would be 85%.

1 In contrast, the two-step process recommended by AT&T is unsupported by any  
2 underlying logic. The sole purpose of the discount is to remove from the retail  
3 rate an estimate of avoided retail costs. That requirement is satisfied by the first  
4 term in the equation; therefore, there is no logical purpose served by applying the  
5 discount a second time.

6  
7 Although there may be no logical reason to discount the cash-back value, it does  
8 have the effect of increasing AT&T's price to the reseller. By applying the  
9 "discount" to a *negative* price (*i.e.*, the cash-back component), the "discount"  
10 becomes a benefit to AT&T (not the reseller). AT&T is attempting to turn the  
11 FCC's avoided-cost pricing rule on its head. By "discounting" a negative price  
12 (the cash rebate), AT&T increases the wholesale price, effectively adding-back  
13 avoided-retail costs.<sup>3</sup>

14  
15 Federal rules do not permit AT&T to arbitrarily reduce the level of avoided-retail  
16 costs (thereby increasing the wholesale price) without any rationale or cost  
17 analysis. As such, its methodology must be rejected.

18  
19 **Q. How is your rebuttal testimony structured?**  
20

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<sup>3</sup> As I explain in the final section of my testimony (page 14-16), AT&T's methodology can (and frequently does) produce a wholesale price that is *higher* than the retail price, a relationship that violates the federal wholesale pricing rule (retail minus avoided cost) on its face.

A. My testimony is structured to separately address each component of the equations above. I first address the term that is common to both equations – that is, the term in the equations that applies the wholesale discount to the retail price to determine the level of avoided retail cost that must be removed to comply with federal pricing rules. I then address the second term in the equation where the parties differ.

## II. The First Term in the Calculation

$$\begin{aligned} \text{AT\&T Proposal} &= (\text{Discount}) \times (\text{Retail Rate}) - (\text{Discount}) \times (\text{Cash-Back}) \\ \text{Reseller Proposal} &= (\text{Discount}) \times (\text{Retail Rate}) - (\text{Cash-Back}) \end{aligned}$$

**Q. What does the first term in the wholesale rate calculation (that is common to both the AT&T and reseller proposals) represent?**

A. The first component of the equation determines the avoided cost of the service in question. It is this term of the equation that complies with FCC rules requiring that the wholesale price be calculated as the retail rate reduced by avoided retail costs:

## 47 C.F.R. § 51.607 Wholesale Pricing Standard

The wholesale rate that an incumbent LEC may charge for a telecommunications service provided for resale to other telecommunications carriers shall equal the rate for the telecommunications service, less avoided retail costs, as described in section 51.609.

1 The avoided-cost calculation used by state commissions generally consists of two  
2 steps: (1) the summation of total avoided costs,<sup>4</sup> and (2) the translation of the total  
3 dollar amount to a percentage of retail revenues, thereby producing a factor to  
4 determine the avoided retail costs of individual services.

5  
6 **Q. Do you agree that applying a percentage discount is a reasonable way to**  
7 **remove avoided retail costs and establish the wholesale price for an**  
8 **individual service?**

9  
10 A. Yes. The basic assumption underlying the approach is that higher priced retail  
11 services give rise to more marketing and customer-care costs and, therefore, it is  
12 reasonable to attribute the avoided costs to individual services as a percentage of  
13 the retail rate. For instance, several of the cash-back promotions introduced by  
14 AT&T have been designed to increase the sale of its higher-priced Complete  
15 Choice services. The methodology used by the Commission assumes that the

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<sup>4</sup> Specifically, 47 C.F.R. § 51.609(c) requires:

For incumbent LECs that are designated as Class A companies under §32.11 of this chapter, except as provided in paragraph (d) of this section, avoided retail costs shall:

- (1) Include as direct costs, the costs recorded in USOA accounts 6611 (product management and sales), 6613 (product advertising), 6621 (call completion services), 6622, (number services), and 6623 (customer services) (§§32.6611, 32.6613, 32.6621, 32.6622, and 32.6623 of this chapter);
- (2) Include, as indirect costs, a portion of the costs recorded in USOA accounts 6121–6124 (general support expenses), 6720 (corporate operations expenses), and uncollectible telecommunications revenue included in 5300 (uncollectible revenue) (Secs. 32.6121 through 32.6124, 32.6720 and 32.5300 of this chapter); and
- (3) Not include plant-specific expenses and plant non-specific expenses, other than general support expenses (§§32.6112–6114, 32.6211–6565 of this chapter).

1 avoided-costs are proportional to the retail rate, so that the resale margin for a  
2 higher-priced retail service like Complete Choice is larger than the margin on  
3 basic local service alone.

4  
5 **Q. Does Dr. Taylor agree that the Commission’s avoided cost methodology**  
6 **assumes that avoided costs are higher for higher-priced services?**

7  
8 A. It is unclear. Dr. Taylor’s testimony suggests that he may agree with the math,  
9 but not the logic. Specifically, Dr. Taylor claims (but does not prove) that most  
10 avoided costs are “common costs” and that “there is no economically meaningful  
11 way to assign those common costs to particular services.”<sup>5</sup> As such, Dr. Taylor’s  
12 testimony is that *any* assignment of avoided costs to an individual service is  
13 arbitrary.<sup>6</sup>

14  
15 Although I would agree with Dr. Taylor that some marketing and customer-care  
16 costs may be common, the “rough justice” method of proportional assignment  
17 used by the Commission is reasonable. Dr. Taylor seems to accept that the  
18 methodology is reasonable for every other service – and for *every* month of the

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<sup>5</sup> Taylor Direct at 9.

<sup>6</sup> It is somewhat ironic that, after characterizing the wholesale discount as an arbitrary method of determining the avoided cost of a particular service, Dr. Taylor devotes 20 pages of testimony arguing in favor of a calculation method that he *claims* maintains the percentage relationship. I explain in the following section of my testimony, however, that Dr. Taylor’s “fixed percentage” argument is really a “change the revenue base” argument and, as such, is nothing more than an unsupported adjustment to the avoided cost calculation adopted by the Commission.

1 services in question here – with the sole exception of the month that a credit is  
2 processed to a reseller as part of a cash-back promotion.

3  
4 In any event, the first term of the equation requires little explanation or discussion  
5 because it is common to both approaches and familiar to the Commission. As  
6 noted above, it is this term of the equation that implements the FCC’s requirement  
7 that the wholesale price “shall equal the rate for the telecommunications service,  
8 less avoided retail costs.”<sup>7</sup>

9  
10 Having established a methodology to remove the avoided retail cost for each  
11 service, the Commission cannot change this estimate without an evidentiary basis  
12 that demonstrates that a lower (or different) level of avoided cost is appropriate.  
13 It is here, in the second term of the equation, that the central dispute arises, in  
14 particular with AT&T’s proposal to reduce the level of avoided retail costs  
15 because it has chosen to offer cash-back promotions that must be available for  
16 resale.

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<sup>7</sup> See 47 C.F.R § 51.607. Emphasis added.



### III. The Second Term in the Calculation

AT&T Proposal = (Discount) x (Retail Rate)– **(Discount) x (Cash-Back)**  
Reseller Proposal = (Discount) x (Retail Rate)– **(Cash-Back)**

**Q. What is the economic role provided the second term of the equation?**

A. The second term of the equation determines whether a promotion is properly available to resellers. As I explained in my direct testimony,<sup>8</sup> FCC rules require that retail services (including promotions over 90 days) be made available to resellers on the same terms and conditions as they are made available to other customers:

47 C.F.R. § 51.605(b): A LEC must provide services to requesting telecommunications carriers for resale that are equal in quality, subject to the same conditions, and provided within the same provisioning time intervals that the LEC provides these services to others, including end users.

My direct testimony explained that the full value of the cash-back promotion must be provided to resellers, just as it is offered to other customers, in order to comply with this rule. In contrast, AT&T proposes to *reduce* the value of the cash-back offering when purchased by the reseller by applying the wholesale discount to the cash-back amount, in effect reducing the margin intended to remove the avoided-costs from the retail price.

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<sup>8</sup> See Gillan Direct at 5. In the filed direct, there was a typographical error that incorrectly identified the applicable rule as 47 C.F.R. § 51.603(b). I intend to correct this typographical error when my direct testimony is introduced at hearing.

1       **Q.     Does it make sense to “discount” the value of a cash-back promotion**  
2               **pursuant to AT&T’s proposed methodology when it is provided the reseller?**

3  
4       A.     No. As noted, the purpose of the wholesale discount is to *remove* marketing and  
5               customer-care costs from a retail price so that the wholesale price is lower than  
6               the retail price (by the estimate of avoided cost). This requirement is *fully*  
7               accomplished when the discount is applied to the standard retail rate (which is the  
8               first term of the equation); there is no continuing role for the wholesale discount  
9               in the calculation. Once applied to the retail rate, the proper estimate of the  
10              avoided cost is removed and the full purpose of the wholesale discount is  
11              achieved.

12  
13             AT&T’s calculation is the perfect example of an algebraic equation disconnected  
14             from reality. The way AT&T applies the discount, AT&T artificially reduces the  
15             avoided-cost estimate, as though there are negative avoided costs that can be  
16             “added-back” to the calculation. But there is no such thing as a “negative avoided  
17             cost.” Significantly, there is *nothing* in AT&T’s testimony that tries to explain  
18             what changed during the promotional month that would justify AT&T removing  
19             fewer avoided costs in that month than in every other month for the same service.

20  
21       **Q.     If there is no substantive explanation that would justify discounting the**  
22               **promotion, why does AT&T claim that it is appropriate to do so?**

1 A. AT&T's entire explanation (repeated over nearly 20 pages) is that discounting the  
2 cash-back credit is necessary to keep the percentage discount the same. However,  
3 AT&T is not maintaining a constant wholesale discount from the retail price,  
4 which is how the Commission determined its percentage discount in accordance  
5 with federal rules. Rather, AT&T is calculating the discount as a percentage of  
6 the retail price less the cash-back promotion. By shrinking the denominator to fit  
7 the percentage, AT&T claims it is maintaining the same percentage without ever  
8 explaining the percentage of *what*?

9  
10 Dr. Taylor's claim that he is maintaining the same discount – and his corollary  
11 claim that the resellers are changing it – is really a debate concerning the  
12 appropriate base for the calculation. When the correct base is used, it is the  
13 resellers that are maintaining the same discount percentage, and it is AT&T that is  
14 reducing it without cause.

15  
16 **Q. Can you provide an example that illustrates how AT&T is reducing the**  
17 **wholesale discount, while the resellers' proposal keeps it the same?**

18  
19 A. Yes. Let me use the same hypothetical that Dr. Taylor adopts in his testimony  
20 that assumes a \$75 retail product, a 14.8% wholesale discount, and a \$50 cash-  
21 back promotion.<sup>9</sup> The Table below summarizes the relevant calculations:

22  

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<sup>9</sup> This hypothetical underlies the analyses presented in Tables B (at 16) and C (at 21) in Dr. Taylor's direct testimony.

### Comparison of AT&T and Reseller Proposals

	Retail/Wholesale Relationship No Promotion	Retail/Wholesale Relationship - Reseller Proposal	Retail/Wholesale Relationship - AT&T Proposal
Retail Price	\$75.00	\$75.00	\$75.00
After \$50 Cash Back		\$25.00	\$25.00
Wholesale Price	\$63.90	\$13.90	\$21.30
Margin	\$11.10	\$11.10	\$3.70
Discount:			
as % of Retail Price	14.8%	14.8%	4.93%
as % of (Retail-Cash Back)		44.4%	14.8%

**Q. In the example above, what is the appropriate level of avoided retail cost that must be removed to comply with federal rules?**

A. First – and this is an absolutely critical point – the Table *directly* answers this question, without interpretation or dispute. Under the Commission’s methodology, the level of avoided cost associated with this product is \$11.10 per month. The purpose of the discount adopted by the Commission is to distribute a total avoided cost among the various retail services. As I noted at the outset, while Dr. Taylor may believe the calculation is arbitrary, the fact remains that the methodology adopted by the Commission calculates avoided costs as proportional to price, which *is* the calculation in the first column.<sup>10</sup> No additional calculations are needed – the level of avoided cost that must be removed from the retail price

<sup>10</sup> I note that Dr. Taylor otherwise finds this approach reasonable. See Taylor Direct at 9:

Q. WHY IS THE AVOIDED-COST DISCOUNT CALCULATED AS A UNIFORM PERCENTAGE DISCOUNT?

A. It is calculated that way partly for administrative ease and partly for a good economic reason.

1 (given the facts in the hypothetical) is \$11.10 and that amount does not change  
2 just because AT&T has decided to introduce a cash-back promotion.

3  
4 Second, as the Table makes clear, removing the same estimate of avoided cost  
5 preserves the discount adopted by the Commission, so long as the basis for the  
6 discount is the retail rate (as required by federal rules). In contrast, Dr. Taylor  
7 proposes to *change* the base of the discount (to the retail rate less the promotion),  
8 claiming that the result is consistent with the FCC's regulations.

9  
10 **Q. Is Dr. Taylor's proposal to change the base of the avoided cost calculation**  
11 **correct?**

12  
13 A. No. The FCC's rule makes clear that the wholesale rate shall be the retail price  
14 reduced by avoided retail costs, and the Commission's methodology produces a  
15 *known* estimate of avoided retail costs as a percentage of the retail rate (in the  
16 hypothetical above, \$11.10). The calculation is grounded in a basic logic that  
17 higher-priced services are proportionally responsible for higher levels of  
18 marketing and customer-care costs, and there is no change in this basic  
19 relationship caused by the promotion.

20  
21 There is nothing in Dr. Taylor's testimony that remotely explains why these  
22 avoided costs have suddenly declined simply because AT&T has offered a cash-  
23 back promotion. Dr. Taylor keeps repeating the claim that the cash-back

1 promotion must be reduced to keep the percentage discount the same, but his  
2 calculation only holds if the base is *changed* from the Retail Price (to the Retail  
3 Price minus the Cash-Back promotion) to determine avoided-cost.. But that  
4 calculation would make sense (with regards to calculating the level of avoided  
5 cost) only if there were some quantifiable link between the Cash-Back promotion  
6 and a temporary diminution of AT&T's avoided cost. Dr. Taylor offers no such  
7 link.<sup>11</sup>

8  
9 **Q. Dr. Taylor also claims (using the same hypothetical) that the resellers'**  
10 **proposal increases the wholesale discount to 44.4%.<sup>12</sup> Is this correct?**

11  
12 A. No. When the discount is calculated from the correct base (the Retail Price), the  
13 wholesale discount is exactly as established by the Commission (14.8%).  
14 As I explained above, the logic of the discount is to comply with federal rules  
15 requiring a wholesale price that "shall equal the rate for the telecommunications  
16 service, less avoided retail costs."<sup>13</sup> As I explain above, this requirement is met –  
17 and only met – by removing the same estimate of avoided cost from the retail rate.

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<sup>11</sup> I note that Dr. Taylor is not overly confident in his own recommendation, freely admitting it is no more economically correct than the alternative. See Taylor Direct at 22-23 comparing the reseller's proposal (Table 2) to his own recommendation (Table 1):

Q. WHICH WHOLESALE DISCOUNT IS CORRECT – A CONSTANT DOLLAR MARGIN AS SHOWN IN TABLE 2 OR A CONSTANT PERCENTAGE MARGIN AS SHOWN IN TABLE 1?

A. Neither form of wholesale discount is necessarily better than the other from a purely economic perspective.

<sup>12</sup> Taylor Direct at 21.

<sup>13</sup> 47 C.F.R. § 51.607.

1 Although a cash-back credit is a reduction in the price paid by the consumer  
2 (which is why its value must also be provided the reseller), that fact alone does  
3 not change how the avoided-cost calculation should be made. The appropriate  
4 measure of avoided cost is *still* accomplished by multiplying the discount times  
5 the retail rate, consistent with the Commission's orders and the methodology that  
6 the Commission used to set the discount.

7  
8 **Q. Can you show how AT&T's discounting of the Cash-Back promotion**  
9 **produces a mathematically impossible result?**

10  
11 A. Yes. While there always disputes over the meaning of federal pricing rules, there  
12 is one mathematical relationship that must exist in order to comply with the rule  
13 concerning resale: that is, the wholesale price *must be* less than the retail price.  
14 The wholesale pricing standard requires that the wholesale price "shall equal the  
15 rate for the telecommunications service, less avoided retail costs."<sup>14</sup>  
16 Mathematically, if you *subtract* a positive number from any other number – and  
17 there is no conceivable claim that avoided retail costs are less than zero – then the  
18 answer *must be* a smaller number.

19  
20 **Q. Can the AT&T methodology produce an impossible result – i.e., a wholesale**  
21 **price that is *higher* than the retail price?**  
22

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<sup>14</sup> See 47 C.F.R § 51.607

1       A.     Yes. Not only *can* it produce such a result, but AT&T provides just such an  
2       example because it *does* produce that result. Specifically, Dr. Taylor analyzes the  
3       consequences of AT&T's methodology on a hypothetical \$100 cash back  
4       promotion (from a \$75 retail rate).<sup>15</sup> As Dr. Taylor shows with this hypothetical,  
5       his recommended methodology produces a wholesale price of (-\$21.30), and a  
6       promotional retail rate of (-\$25.00). Because both numbers are negative, the  
7       (-\$21.30) wholesale price is *higher* than the retail price of (-\$25.00). Dr. Taylor  
8       apparently appreciates the quandary his methodology creates, as illustrated by the  
9       following "footnote explanation" in his testimony:

10               Note also that even though the effective retail price is smaller  
11               (more negative) than the wholesale price, the wholesale price is  
12               still 14.8% less than the retail price, as required by the  
13               Commission's orders and the relevant interconnection  
14               agreements.<sup>16</sup>  
15

16       Dr. Taylor starts right yet finishes wrong. He admits that the retail price is  
17       *smaller* than the wholesale price, but then claims the wholesale price is 14.8%  
18       *less than* the retail price. Factually and unambiguously, the wholesale price is  
19       14.8% *larger than* the retail price, because as Dr. Taylor concedes (if concession  
20       is the right word to describe consensus on a mathematical property, not a  
21       theoretical opinion), the retail price is the smaller of the two. As a result, the  
22       wholesale price is not 14.8% *less* than the retail price (as claimed in the later part

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<sup>15</sup>       See Taylor Direct, Table D at 25.

<sup>16</sup>       Taylor Direct at 28, footnote 7.



1 of the footnote), it is 14.8% *greater* than the retail price, violating every  
2 requirement of the federal pricing rule.

3  
4 The wholesale price that is 14.8% *less than* the retail rate of -\$25.00 is -\$28.70.

5 Consequently, if the Commission agrees with Dr. Taylor that it must discount the  
6 cash-back promotion, then it must make clear in the implementation of that  
7 decision that the wholesale rate is always *lower* (in this case, more negative) than  
8 the retail price.

9  
10 **Q. Dr. Taylor's testimony used a hypothetical to illustrate a promotion where**  
11 **the AT&T methodology creates a wholesale price higher than the retail rate.**  
12 **Is this hypothetical representative of the promotions at issue here?**

13  
14 **A.** Yes. As demonstrated by the Stipulation summarizing AT&T's promotions, it is  
15 common for AT&T to introduce promotions that, under AT&T's proposed  
16 methodology, result in a situation where the wholesale price is above the retail  
17 price. This circumstance may have been discussed near the end of Dr. Taylor's  
18 testimony, but that placement does not reflect its frequency in the real world. The  
19 wholesale-over-retail result is more the rule than the exception when it comes to  
20 applying the AT&T methodology to its promotions.

1       **Q.     Is it possible to comply with the federal wholesale pricing standard with a**  
2               **wholesale price that is greater than the retail rate (as proposed by Dr.**  
3               **Taylor)?**

4  
5       A.     No, it is not. As I explained above, the only way that the wholesale pricing  
6               standard could be satisfied by a wholesale rate greater than the retail rate is if  
7               there are *negative* avoided costs that when *subtracted* from the retail rate, produce  
8               a higher number.

9  
10      **Q.     How does Dr. Taylor justify a methodology that produces a wholesale rate**  
11             **that is higher than the retail rate?**

12  
13      A.     To be clear, Dr. Taylor never does try and justify how his methodology complies  
14             with federal pricing rules, or by offering any explanation as to what would cause  
15             the wholesale price to legitimately rise above the retail rate (by the removal of  
16             avoided cost). Rather, he offers a lengthy (yet irrelevant) discussion as to why it  
17             might make sense for AT&T to offer a promotion that produces a negative retail  
18             rate to attract new customers.<sup>17</sup> However, it does not matter *why* AT&T would  
19             offer such a promotion; this case is not about whether the promotion makes sense  
20             for AT&T, it is solely concerned with addressing whether AT&T has correctly  
21             made it available for resale.

22  

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<sup>17</sup>     See Taylor Direct at 28.

1 In this regard, Dr. Taylor never addresses the sole relevant question: Does his  
2 methodology comply with federal pricing (and nondiscrimination) rules.

3 Obviously, if Dr. Taylor's methodology only complies with federal rules in a  
4 world characterized by an impossible circumstance (*i.e.*, a world with negative  
5 avoided costs), there must be a fundamental flaw in his logic. As shown above,  
6 that flaw occurs in the second term of the equation, where he proposes to apply  
7 the wholesale discount to the cash-back credit, thereby diluting the avoided-cost  
8 calculation of the Commission.

9  
10 Perhaps because Dr. Taylor believes that any assignment of avoided cost to an  
11 individual service is arbitrary, it is acceptable to arbitrarily reduce the level set by  
12 the Commission. I disagree. AT&T has a statutory obligation to remove the  
13 avoided cost from its retail prices,<sup>18</sup> and the Commission has made a good-faith  
14 effort to do so by applying a wholesale discount to the standard rate. Although  
15 the cash-back credit does reduce the effective retail price as perceived by the  
16 consumer, that does not mean it has changed, in any way, the level of avoided  
17 cost that must be removed from the retail cost to comply with federal rules. The  
18 methodology recommended by my direct testimony properly calculates the  
19 wholesale rate and the Commission should require that AT&T comply with the  
20 methodology.

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<sup>18</sup> The Commission should also remember that AT&T's statutory obligations did not come without other statutory benefits, including the opportunity to enter the long distance business. AT&T has benefited immensely from the additional lines of business that it was permitted to engage in, exemplified by its name (acquired in its merger with AT&T).

1       **Q.     Does this conclude your rebuttal testimony?**

2

3       **A.     Yes.**

**BEFORE**

**THE PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA**

**DOCKET NOS. 2010-14--19-C**

IN RE: )

)  
BellSouth Telecommunications, )  
Incorporated d/b/a AT&T Southeast )  
d/b/a AT&T South Carolina v. )  
Affordable Phone Services, Incorporated )  
d/b/a High Tech Communications )  
**Docket No. 2010-14-C** )

)  
BellSouth Telecommunications, )  
Incorporated d/b/a AT&T Southeast )  
d/b/a AT&T South Carolina v. Dialtone )  
& More Incorporated )  
**Docket No. 2010-15-C** )

)  
BellSouth Telecommunications, )  
Incorporated d/b/a AT&T Southeast )  
d/b/a AT&T South Carolina v. )  
Tennessee Telephone Service, LLC )  
d/b/a Freedom Communications USA, )  
LLC )  
**Docket No. 2010-16-C** )

)  
BellSouth Telecommunications, )  
Incorporated d/b/a AT&T Southeast )  
d/b/a AT&T South Carolina v. OneTone )  
Telecom, Incorporated )  
**Docket No. 2010-17-C** )

)  
BellSouth Telecommunications, )  
Incorporated d/b/a AT&T Southeast )  
d/b/a AT&T South Carolina v. dPi )  
Teleconnect, LLC )  
**Docket No. 2010-18-C** )

)  
BellSouth Telecommunications, )  
Incorporated d/b/a AT&T Southeast )  
d/b/a AT&T South Carolina v. Image )  
Access, Incorporated d/b/a New Phone )  
**Docket No. 2010-19-C** )

**CERTIFICATE OF SERVICE**

The undersigned hereby certifies that a copy of the **Direct Rebuttal Testimony of Joe Gillan** has been served by electronic mail service on the following this 1st day of October, 2010:

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s/ John J. Pringle, Jr.  
John J. Pringle, Jr.